

Chairperson and Committee Members
AUDIT AND RISK COMMITTEE

13 SEPTEMBER 2018

Meeting Status: **Public**

Purpose of Report: For Information

TREASURY MANAGEMENT COMPLIANCE

PURPOSE OF REPORT

- 1 This report provides confirmation to the Audit and Risk Committee of Council's compliance with its Treasury Management Policy (Policy) for the quarter ended 30 June 2018.

DELEGATION

- 2 The Audit and Risk Committee has delegated authority to consider this report under the following delegation in the Governance Structure, Section B.3.
Ensuring that Council has in place a current and comprehensive risk management framework and making recommendations to the Council on risk mitigation.

BACKGROUND

- 3 The Policy sets out a framework for the Council to manage its borrowing and investment activities in accordance with Council objectives and incorporates legislative requirements.
- 4 The Policy mandates regular treasury reporting to management and Council's Operations and Finance Committee, and quarterly compliance reporting to the Audit and Risk Committee.
- 5 In order to assess the effectiveness of Council's treasury management activities and compliance to the Policy, certain performance measures and parameters have been prescribed. These are as follow:
 - Cash/Debt position
 - Liquidity/Funding control limits
 - Interest rate risk control limits
 - Counterparty Credit risk
 - Specific Borrowing Limits
 - Risk management performance
- 6 This report is the last compliance assessment against the September 2017 policy, as an updated the Policy (refer to Corp-18-541) was approved and adopted by the Operations and Finance Committee in July 2018. Future compliance reporting will be done against the newly adopted Policy.

DISCUSSION

Cash/Debt Position

- 7 Table 1 below shows the Council's net debt position as at 30 June 2018 against full year budget and the prior year closing balance.

Table 1	June YTD Actual \$000's	Full Year Budget \$000's	Full Year Variance \$000's	Full Year 2016/17 \$000's
External debt	205,000	186,548	(18,452)	210,000
less borrower notes	(3,280)	(2,960)	320	(3,360)
less cash investments	(53,552)	(15,200)	38,352	(60,455)
Net debt	148,168	168,388	20,220	146,185

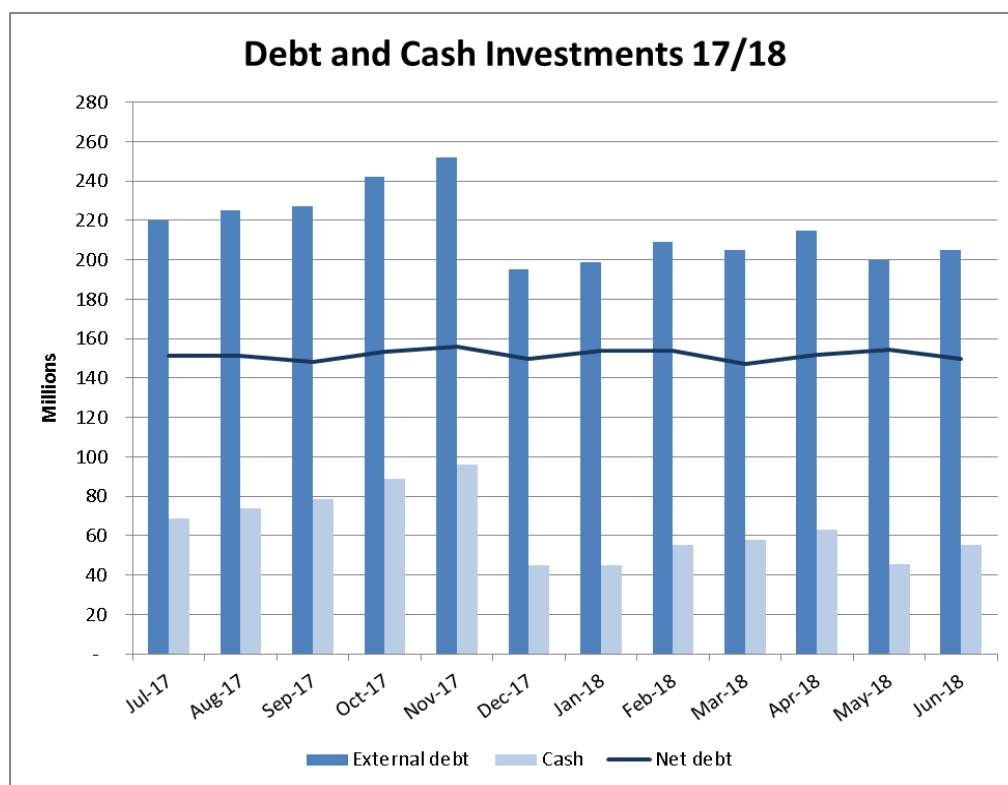
- 8 During the past twelve months, the Council issued \$75 million of new debt, with \$80 million of debt maturing. \$70 million of the matured debt was prefunded and held on term deposit with the remaining \$10 million refinanced on the day.
- 9 The Table below shows the movement in the Council's debt balance for the year.

Borrowings	Gross borrowings	Explained by:					Capital works programme 2017/18 Spend
		Refinancing borrowings	Pre-funding borrowings				
		December 2017 maturity	TD December 2017	TD May 2018	TD March 2019	TD September 2019	
	\$000	\$000	\$000	\$000	\$000	\$000	
Opening balance 1 July 2017	210,000	-	45,000	15,000	-	-	-
New Debt issued YTD	75,000	10,000	5,000	5,000	30,000	15,000	10,000
Maturities	(80,000)	(10,000)	(50,000)	(20,000)	-	-	-
Total	205,000	-	-	-	30,000	15,000	10,000

- 10 As at 30 June 2018, the Council had \$56.8 million of cash, term deposits and borrower notes. This is broken down as follows:

Term deposits & Borrower Notes	Prefunding borrowings	Prefunding capex	Borrower notes	Cash	Total cash, term deposits and borrower
	\$000	\$000	\$000	\$000	\$000
LGFA debt maturing March 2019	30,000	-	-	-	30,000
LGFA debt maturing September 2019	15,000	-	-	-	15,000
Surplus cash placed on TD for Capital Works Programme maturing August (\$2.5m) and October (\$4.5m)	-	7,000	-	-	7,000
Surplus cash	-	-	-	1,552	1,552
Borrower notes held	-	-	3,280	-	3,280
Total	45,000	7,000	3,280	1,552	56,832

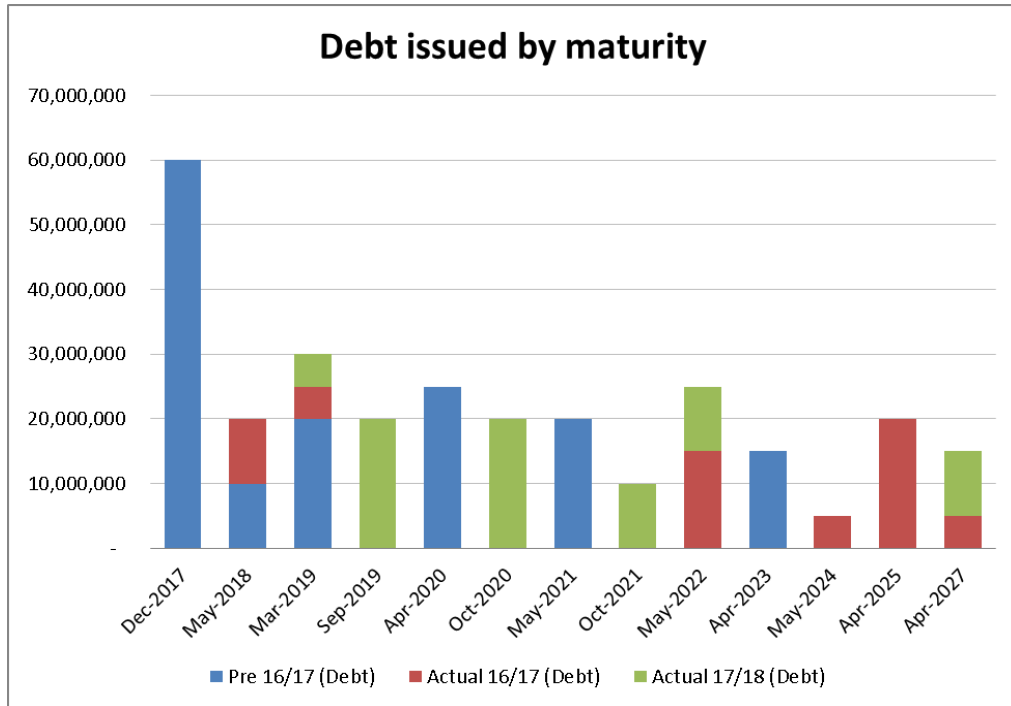
- 11 The Council is targeting through its financial strategy to bring net borrowings below 200% of operating income. As of the end of June the Council’s net borrowings as a share of operating income is 198%. This is a good result for the Council and show’s that reducing the capital programme in 2017/18 went a significant way towards achieving the aims of the financial strategy.
- 12 Excluding prefunding, the Council has not breached its upper borrowing limit as demonstrated in the chart below:



Liquidity/Funding control limits

- 13 Liquidity and funding management focuses on reducing the concentration of risk at any point so that the overall borrowings cost is not increased unnecessarily and/or the desired maturity profile is not compromised due to market conditions. This risk is managed by spreading and smoothing debt maturities and establishing maturity compliance buckets.
- 14 Since October 2015 the Council’s treasury strategy has included a significant prefunding programme. The policy allows pre-funding of Council debt maturities up to 18 months in advance, including re-financing. Market conditions have been favourable for this approach, where the Council draws down debt early and is able to invest the funds for a positive net return.
- 15 A key objective in commencing this approach was to prepare for managing a concentration of liquidity risk. The Council had \$80 million of debt maturing in 2017/2018 with \$60 million in December 2017 and another \$20 million in May 2018. If the Council were to wait until that maturity date before refinancing, assuming full refinancing is possible, the Council is exposed to the risk that market conditions are unfavourable at that time, and is forced to refinance a significant portion of its debt portfolio at high interest rates.

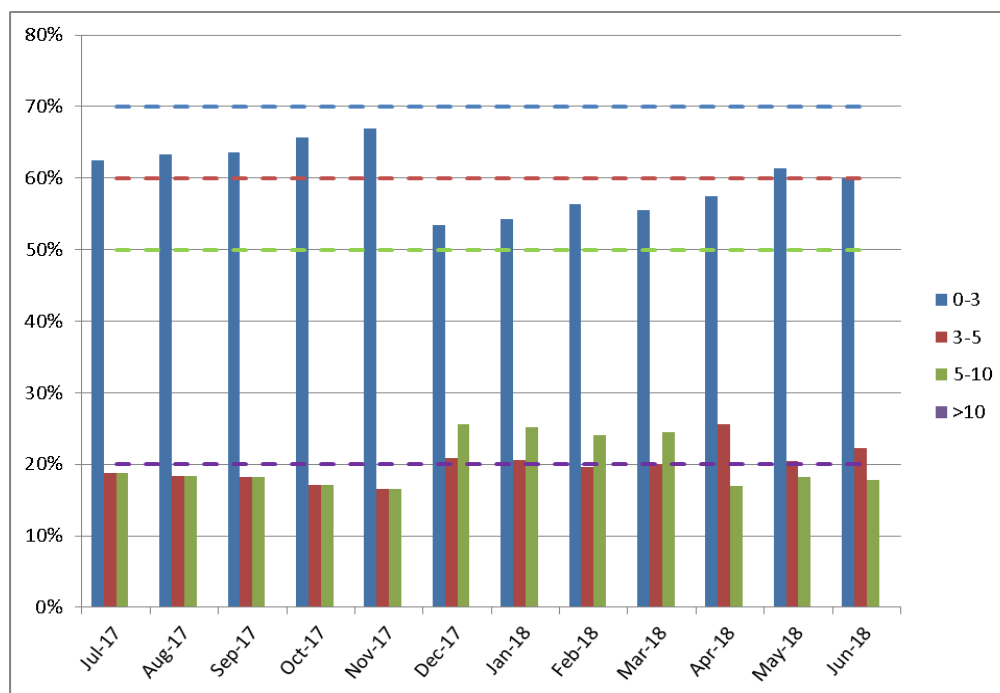
- 16 The graph below presents Council’s debt maturity dates in relation to the financial year in which the debt was issued. This demonstrates that since 2016/17, Council has actively reduced risk concentration by spreading debt maturity dates and debt maturity values.



- 17 Debt maturities must fall within compliance buckets. The buckets are:

Period	Minimum	Maximum
1 to 3 years	10%	70%
3 to 5 years	10%	60%
5 to 10 years	10%	50%
10 years plus	0%	20%

- 18 For the year ending 30 June 2018, the Council has been fully compliant with its debt maturity limits, as shown by the chart below. The upper limits, as shown by dashed lines, relate to the bars of the same colour. For example, the 0-3 year upper limit of 70% is in blue. Actual maturities in the 0-3 year bucket are represented by the blue bars.



Interest rate risk control limits

- 19 Council issues all debt on a floating rate basis, as lower interest rates are realised this way, and uses fixed interest rate swaps to minimise exposure at any one time to interest rate fluctuations.
- 20 Without such hedging, the Council would have difficulty absorbing adverse interest rate movements. A 1% increase in interest rates on \$150 million in net debt would equate to additional interest expense of \$1.50 million per annum. Conversely, fixing interest rates does however reduce Council’s ability to benefit from falling and/or more favourable interest rate movements.
- 21 The objectives of any treasury strategy are therefore to smooth out the effects of interest rate movements, while being aware of the direction of the market, and to be able to respond accordingly.

Major control limit

- 22 The Policy ensures that, at any point in time, the total notional amount of all interest rate risk management instruments (i.e. interest rate swaps) must not exceed Council’s total actual debt.

- 23 The table below shows that the Council’s hedging was fully compliant with this Major control limit for the quarter ending 30 June 2018 as less than 100% of the external debt balance was fixed at any point in time.

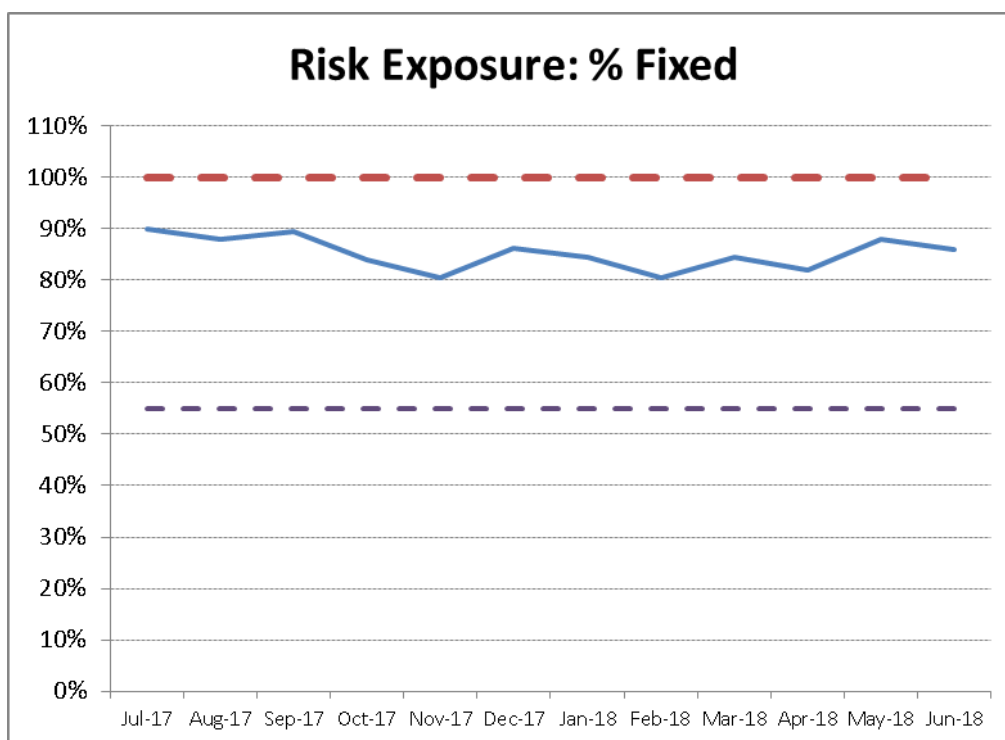
\$000's	Apr-18	May-18	Jun-18
External debt (floating rate)	215,000	200,000	205,000
Swaps (fixed portion)	175,938	175,938	175,938
Fixed %	81.8%	88.0%	85.8%
Unfixed debt	39,063	24,063	29,063

Master Fixed/Floating Risk Control Limit

- 24 Exposure to interest rate risk is managed and mitigated through risk control limits.
- 25 Hedging of Council’s debt must be within the following fixed/floating risk control limits:

	Minimum	Maximum
Council’s fixed/floating risk control limits	55% Fixed	100% Fixed

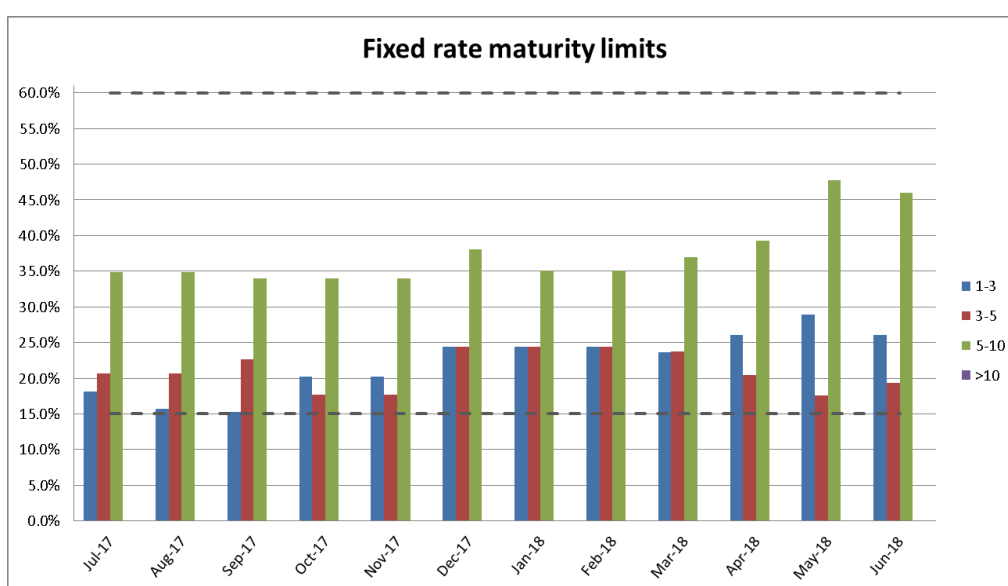
- 26 The following graph shows that the Council’s hedging for the year ended 30 June 2018 was fully compliant with these limits.



27 Similarly to debt maturities, hedging instrument maturities must also fall within compliance buckets. These compliance buckets are as follows:

Period	Minimum	Maximum
1 to 3 years	15%	60%
3 to 5 years	15%	60%
5 to 10 years	15%	60%
10 years plus	0%	20%

28 The Council has been fully compliant, as shown by the following chart. Note that maturities falling within 1 year are not included. There was a significant amount of hedging in place for the \$80 million of debt that matured within the 2017/18 financial year.



Counterparty Credit Risk

29 The policy sets limits for the maximum that can be traded per counterparty. The purpose of this is to ensure the Council does not concentrate its investments with a single party.

30 The policy sets the gross counter party limits as follows:

Counterparty/Issuer	Minimum Standard and Poor's long term	Investments maximum per counterparty	Risk management instruments maximum per counterparty	Borrowing maximum per counterparty
NZ Government	N/A	Unlimited	None	Unlimited
LGFA	AA-/A-1	\$20m	None	Unlimited
NZ registered bank	A+/A-1	60% of total investments or \$25m; whichever is greater.	50% of total investments or \$25m; whichever is greater.	\$50m

- 31 The tables below show Council's investments and risk management instruments holdings per counter party during the quarter.

Term deposits

Counter party	Apr-2018		May-2018		Jun-2018		Compliance
	\$000	%	\$000	%	\$000	%	
NZ Registerd Bank 1	10,000	16.81%	10,000	23.53%	14,500	27.88%	✓
NZ Registerd Bank 2	19,500	32.77%	12,500	29.41%	17,500	33.65%	✓
NZ Registerd Bank 3	10,000	16.81%	-	0.00%	-	0.00%	✓
NZ Registerd Bank 4	20,000	33.61%	20,000	47.06%	20,000	38.46%	✓
	59,500	100%	42,500	100%	52,000	100%	

*Policy Limit: 60% of total investments or \$25million; whichever is greater

Interest rate swaps

Counter party	Apr-2018		May-2018		Jun-2018		Compliance
	\$000	%	\$000	%	\$000	%	
NZ Registerd Bank 1	50,000	28.42%	55,000	31.26%	55,000	31.26%	✓
NZ Registerd Bank 2	75,938	43.16%	80,938	46.00%	80,938	46.00%	✓
NZ Registerd Bank 3	50,000	28.42%	40,000	22.74%	40,000	22.74%	✓
	175,938	100%	175,938	100%	175,938	100%	

*Policy Limit: 50% of total instruments or \$80million; whichever is greater

- 32 Council was in full compliance with all counterpart credit limits during the quarter ended 30 June 2018.

Specific Borrowing Limits

- 33 In managing debt, Council is required to adhere to the limits below with the actual performance for the year in the 2017/18 column.

Borrowing limit	Policy limit	2017/18
Net interest expense/Total Operating Income (YTD)	< 20%	10.1%
Liquidity ((total debt +total committed facilities +cash on hand)/total debt) (YTD)	> 110%	135.9%
Net External Debt /Total Operating Income (as at 30 June 2018)	< 240%	198.3%

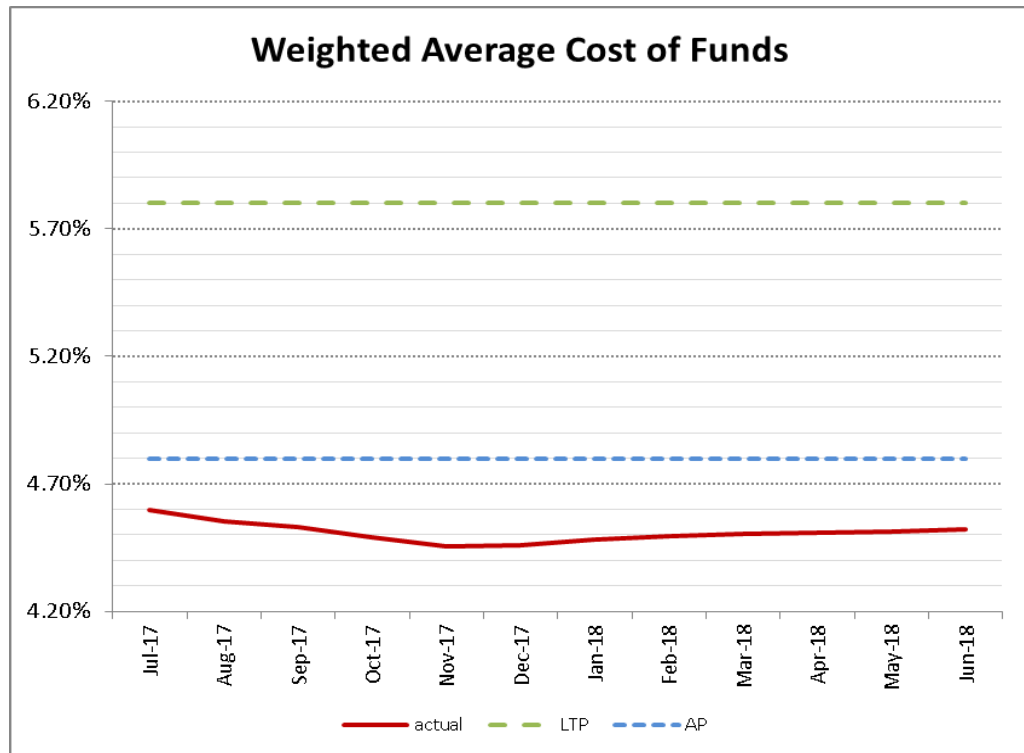
Risk Management Performance

- 34 The following table shows the Council's interest income and expense for the quarter, along with the weighted average cost of borrowing (WACB).

	June YTD Actual \$000's	YTD Budget \$000's	YTD Variance \$000's
External Finance Expense	9,793	9,543	(250)
/less: Interest Received	(2,269)	(1,520)	748
Net Interest Costs	7,524	8,023	499
Weighted Average Cost of Funds	4.52%	4.80%	0.28%

35 To provide some context regards Council’s treasury management effectiveness, the net interest costs year to date are \$499,000 less than budget.

36 The following graph shows the cost of borrowing each month. The uplift in the WACB in December 2017 is primarily due to less interest income being realised post 15 December 2017 as Council’s total term deposits were reduced by \$50 million on the same date.



Considerations

Policy considerations

37 There are no policy considerations other than those already noted in this report.

Legal considerations

38 There are no legal considerations arising from this report.

Financial considerations

39 There are no financial considerations other than those already noted in this report.

Tāngata whenua considerations

40 There are no tāngata whenua considerations arising from this report.

SIGNIFICANCE AND ENGAGEMENT

41 This matter has a low level of significance under Council Policy.

Publicity

42 There are no publicity considerations arising from this report.

RECOMMENDATIONS

43 That the Audit and Risk Committee notes that the Council was fully compliant with its Treasury Management Policy for the quarter ended 30 June 2018.

Report prepared by

Anelise Horn
Manager, Financial Accounting

Approved for submission

Kevin Black
Acting Group Manager
Strategy & Planning

Approved for submission

Janice McDougall
Acting Group Manager
Corporate Services